BEFORE THE. STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
) No. 85A-445-GO
HILL AND DALE LAND COMPANY)

For Appellant: Donald E. Bell
Certified Public Accountant

For Respondent: David Lew
Counsel

OPINION

This appeal is made pursuant to section 25666 1/ of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Hill and Dale Land Company against proposed assessments of additional franchise tax in the amounts of $2,683.00 and $788.03 for the income years 1979 and 1982, respectively..

1/ Unless otherwise specified, all section references are to sections of the Revenue and Taxation Code as in effect for the income years in issue.

Appeal of Hill and Dale Land Company

The issue in this appeal is whether appellant and Smokey Valley Ranch were engaged in a single unitary business during the years at issue.

Appellant, a California corporation formed in 1966 for the expressed purpose of real estate sales, is wholly owned by the company's president, Richard H. Guelich, III (hereinafter "Guelich"). Income for the corporation is earned from commissions from sales of real estate and fees from the management of real. estate. Specifically, Guelich provides broker services for the sales of large, mostly undeveloped real. estate to groups of investors, who hold the property for appreciation or for rental to other individuals. Management services include locating tenants and negotiating rental agreements, collecting rents, paying monthly bills, preparing partnership returns, overseeing the property and obtaining any needed financing on behalf of the property owner. Although the corporation claims to have an equity interest in some of the properties with which it deals, it holds none as inventory.

During the years on appeal, appellant held a 25-percent partnership interest in the Smokey Valley Ranch, a Nevada partnership (hereinafter "Smokey Valley"). Guelich also held a 50-percent interest in the partnership on an individual 'oasis. The partnership was apparently created for the purpose of purchasing both improved and unimproved real property, which was then rented out to tenants for farming purposes. Guelich, acting as the managing partner of the partnership, visited the properties six to ten times during the year for a period of time totaling six months for the purpose of managing the partnership's affairs.

For the income years 1979 and 1982, appellant computed its California source income without regard to the income or loss of Smokey Valley. Subsequently, appellant filed amended returns for both of the above years on the ground that it and Smokey Valley were engaged in a single unitary business. In doing so, appellant recomputed its California source income in combination with Smokey Valley which had incurred substantial partnership losses for both 1919 and 1982, Claims for refund were filed for income years 1979 and 1982. Both claims were allowed by respondent.

Upon subsequent audit of the appeal years., respondent determined that Smokey Valley should not have been included in the- computation of appellant's

California source income. This conclusion was based upon a finding that appellant and Smokey Valley were not engaged in a single unitary business. As a result, notices of proposed assessments were issued to appellant for each of the income years on appeal.

There are two alternative tests used to determine whether a business is unitary. The California Supreme Court has held that the existence of a unitary business is definitely established by the presence of unity of ownership; unity of operation as evidenced by central accounting, purchasing, advertising, and management divisions; and unity of use in a centralized executive force and general system of operation. (Butler Bros. v. McColgan, 17 Cal.2d 664 [111 P.2d 334] (1941), affd., 375 U.S. 501 [86 L.Ed. 991] (1942).) It has also stated that a business is unitary if the operation of the business done within California is dependent upon or contributes. to the operation of the business outside California. (Edison California Stores, Inc. v. McColgan, 30 Cal.2d 472 [183 P.2d 16] (1947).) Respondent? determination regarding the existence or nonexistence of a unitary business is presumptively correct, and taxpayers bear the burden of showing that it is incorrect,

To demonstrate the existence of a singie unitary business, *it* is necessary to do more than simply list circumstances which are labeled 'unitary. factors." Such "factors" are distinguishing features of a unitary 'business only when they show that there was functional integration between the corporations or divisions involved. We must distinguish between those cases in which unitary labels are applied to transactions and circumstances which, upon examination, have no. real substance, and those in which the factors involved show such a significant interrelationship amang. the related entities that they all must be considered to be parts of a single integrated economic enterprise,,. (Appeal of Saga Corporation, *Cal. St.* Bd. of Equal., June 29, 1982.)

Appellant contends that it was unitary with Smokey Valley under the three-unities tests because of: unity of ownership; unity of operation "as evidenced by use of the same accountant and [same} legal services" and intercompany loans; and unity of use as evidenced by the centralized management provided by Guelich who was both the president of appellant and the managing partner of Smokey Valley. (App. ltr., Aug. 31, 1984.) Appellant argues that these same activities provided "a mutual

advantage to the two entities." (App. Reply Ltr. at 3.) Respondent agrees that unity of ownership existed, but contends that based upon the "scant evidence" presented by appellant, the other factors relied upon by appellant do not demonstrate a functionally integrated enterprise under either the three-unities test or the contribution or dependency test. Respondent argues that appellant's activities involved real estate sales and management of property which it did not own, while Smokey Valley's activities in Nevada involved equity holdings in farm land which were held for investment purposes. Respondent concludes that the activities of the California corporation and the Nevada partnership were both separate and distinct. (Resp. Br. at 7.)

We note initially that we have previously held that unity of ownership exists per se between a corporation and a partnership to the extent of the corporation's actual ownership in the partnership. (Appeal of Saga Corporation, supra.) Accordingly, the parties are in agreement that unity of ownership exists in this appeai. (See also Cal. Admin. Code, tit. 18, *reg.* 25137-1, subd. (a).) However, based upon the record presented, we find that the factors relied upon by appellant do not show any significant integration of the two companies, but merely show *the* ordinary oversight which would be expected in any closely held-g roug of enterprises. Same centralized services, such as accounting, did exist, but there has been no showing that they resulted in any substantial. mutual advantage. (Appeal of Hollywood Film Enterprises, Inc., Cal. St. Bd. of Equal., Mar. 31, 1982.) Moreover, there was no showing that the financing contributed in any way to the operational integration of the group. Operational unity, therefore, cannot be said to have existed to any meaningful extent. In addition, we find that the executive assistance described. by appellant lacks unitary significance because it did not result in any integration between the entities. (See Appeals of Andreini & Company and Ash Slough Vineyards, Inc., Cal. St. Bd. of Equal., Mar. 4, 1986.) *Moreover,* there is nothing in the record which would establish that appellant's operations depended upon or contributed to the operation of Smokey Valley. Accordingly, the evidence presented by appellant is simply insufficient to support a finding that the two were engaged in a unitary business.

On the basis of the foregoing, we must sustain respondent's action.

Appeal of Hill and Dale Land Company

ORDER

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 25667 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of Hill and Dale Land Company against proposed assessments of additional franchise tax in the amounts of $2,683.00 and $788.03 for the income years 1979 and 1982, respectively, be and the same is hereby sustained.

Done at Sacramento, California, this 19th day Of November, 1986, by the State Board of Equalization, with Board Members Mr. Nevins, Mr. Collis, Mr. Bennett, Mr. Dronenburg and Mr. Harvey present.

Richard Nevins, Chairman

Conway H. Collis, Metier

William M. Bennett, Member

Ernest J. Dronenbura, Jr., Member

Walter Harvey*, Member

*For Kenneth Cory, per Government Code section 7.9